

## **NAA/NMHC Guidance: Using Consumer Credit Reports in the Rental Screening Process Adverse Action, Risk-Based Pricing and Credit Score Disclosure Obligations**

The Fair Credit Reporting Act (FCRA) was enacted in 1970 to promote accuracy, fairness and privacy of the consumer information collected by consumer reporting agencies (CRAs). It was amended in 1996 to include new disclosure requirements for apartment firms that use consumer credit reports to make rental decisions, specifically the adverse action notice.

Subsequent amendments designed to arm the consumer with additional protections and information about their credit standing, as well as address the growing concerns of identity theft, were made by the 2003 Fair and Accurate Credit Transactions Act (FACT Act) and the 2010 Dodd-Frank Wall Street Reform Act (Dodd-Frank).

As a result of those amendments, beginning in July 2011, apartment firms that use a credit report and a credit score when evaluating rental applications must adhere to, in some cases, additional compliance obligations. This document offers, through a Q&A format, some of the key disclosure requirements of the law and its applicability to apartment owners/managers relative to adverse actions, risk-based pricing and credit scores.

### **Fair Credit Reporting Act (as amended in 1996): Adverse Action Notices**

FCRA Section 615(a) requires any person taking an adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report to provide notice of the action to the consumer.

#### **1. What is a consumer report?**

A consumer report is a detailed report that provides personally identifiable information relating to one's credit, character or lifestyle. The FCRA only covers reports prepared by a consumer reporting agency; that is, a company that specializes in compiling the information into a report. Examples of consumer reports used by apartment owners are:

- a credit report from a credit bureau, such as TransUnion, Experian and Equifax or an affiliate company;
- a report from a tenant-screening service that describes the applicant's rental history based on reports from previous landlords or housing court records;
- a report from a tenant-screening service that describes the applicant's rental history, and also includes a credit report the service got from a credit bureau;
- a report from a tenant-screening service that is limited to a credit report the service got from a credit bureau; and
- a report from a reference-checking service that contacts previous landlords or other parties listed on the rental application on behalf of the rental property owner.

#### **2. Is an adverse action notice required when a rental decision is based on information obtained from a person other than a consumer reporting agency, i.e. a previous landlord?**

No.

#### **3. What actions can be construed as adverse actions in the rental application context?**

Adverse action is broadly defined in Section 603(k) of the FCRA to include, among other things, "all actions or determinations adverse to the interests of the consumer made in connection with an application made by or a transaction initiated by a consumer. Examples include the following:

- denying the application;

- requiring a co-signer on the lease;
- requiring a deposit that would not be required for another applicant;
- requiring a larger deposit than might be required for another applicant; and
- raising the rent to a higher amount than for another applicant.

**4. What must be disclosed in an adverse action notice?**

- The name, address and telephone number of the CRA that supplied the consumer report, including a toll-free telephone number for CRAs that maintain files nationwide;
- a statement that the CRA that supplied the report did not make the decision to take the adverse action and cannot give the specific reasons for it; and
- a notice of the individual's right to dispute the accuracy or completeness of any information the CRA furnished, and the consumer's right to a free report from the CRA upon request within 60 days.

**5. What are the consequences of noncompliance?**

- Under the FCRA, an apartment owner can be sued for failing to provide a consumer with the required disclosure notice. In addition to suing for damages in federal court, the individual can sue for punitive damages and the Federal Trade Commission (FTC) can sue for noncompliance.

**Status:** There continues to be an ongoing obligation for apartment owners to provide notice to the consumer when taking an adverse action based on information in a consumer credit report. Disclosure can be oral, written or electronic.

**Fair and Accurate Credit Transactions Act of 2003 (FACT Act): Risk-Based Pricing Notice**

The FACT Act amended the FCRA to enhance the ability of consumers to combat identity theft and to increase the accuracy of consumer report information. It also places additional requirements on “creditors” to provide a risk-based pricing notice to consumers, under certain circumstances. Unlike the adverse action notice obligation imposed on any person who uses a consumer report under FCRA, the risk-based pricing notice only applies to “creditors.” However, see commentary below relative to Ninth Circuit court decision.

**1. Do apartment owners have to provide a risk-based pricing notice?**

Generally, no. Risk-based pricing notices are required when the creditor uses a consumer report (in whole or in part) to grant or extend credit to a consumer on material terms that are “materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through” the creditor. The landlord-tenant relationship is not a “credit” relationship; therefore, there are no obligations under this provision for apartment owners.

In addition to this long-held interpretation, the Federal Trade Commission (FTC) and Federal Reserve Board reaffirmed this by stating in the Final Risk-Based Pricing Rules that “consumer leases are generally not considered credit and thus the rule does not apply,” However, a Ninth Circuit court decision puts this interpretation into question in those states governed by that Circuit. (*Brothers v. First Leasing*, (724 F.2d 789 (9th Cir. 1984.))) While the Federal Reserve has indicated they will not pursue enforcement actions in those states, this does not preclude state enforcement efforts. If you have properties in the Ninth Circuit, please seek counsel for further interpretation.

**Status:** Final rules effective January 1, 2011.

**Dodd-Frank Wall Street Reform and Consumer Protection Act: Credit Score Disclosure**

Section 1100(f) of the Dodd-Frank Act amends Section 615(a) of the FCRA to require the disclosure of the credit score when the adverse action is based in whole or in part on a numerical credit score. ***This is a new disclosure and is scheduled to go into effect July 21, 2011.***

The type of credit scores used by resident screening companies varies. Many have developed models that are not “credit scores” as defined in the statute and are therefore outside of the scope of this notice re-

quirement. Some firms may use a FICO score or a similar score, i.e., one that is used to make a lending decision, and therefore trigger the disclosure requirements. Since the liability falls to the apartment owner, firms are encouraged to talk with their provider(s) to determine compliance obligations and make the appropriate adjustments to the adverse action notice to include credit score disclosure if necessary.

**1. Who must comply with Dodd-Frank credit score disclosures?**

It depends. Since this provision amends the adverse action provisions of FCRA it is not limited to “creditors,” but more broadly regulates the activities of the user of a credit score. Therefore, apartment owners that use a credit score, as defined below, in taking an adverse action relative to the rental decision must provide this new disclosure. However, it is likely that many screening or scoring models currently used by the apartment industry will not trigger this compliance notice.

**2. What is a “credit score” for purposes of this regulation?**

This new disclosure requirement applies to “credit scores” and not other types of scores, such as those used in the apartment resident screening application. In many instances, rental applicant criteria set by apartment owners and managers typically consider factors outside of those used for purposes of making a mortgage loan or credit card decision such as eviction reports, criminal background checks or debt-to-income ratios. As a result, proprietary scores designed for the rental decision are not considered the same as those used for making “credit” decisions.

Credit score has the same definition as found in FCRA Section 609(f)(2)(A)

a) The term “credit score”

- i) means a numerical value or a categorization derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default (and the numerical value or the categorization derived from such analysis may also be referred to as a “risk predictor” or “risk score”); and
- ii) does not include
  - (1) any mortgage score or rating of an automated underwriting system that considers one or more factors in addition to credit information, including the loan to value ratio, the amount of downpayment or the financial assets of a consumer; or
  - (2) any other elements of the underwriting process or underwriting decision.

b) The term “key factors” means all relevant elements or reasons adversely affecting the credit score for the particular individual, listed in the order of their importance based on their effect on the credit score.

**3. If I use a consumer report but not a credit score, am I required to provide a disclosure?**

If a credit score is not considered in making a decision that leads to an adverse action, you have no requirements under this provision. However, you still are obligated to comply with the adverse action notice requirements as described in the FCRA section above.

**4. What information must be included in the credit score notice?**

- the credit score used by the person in making the credit decision;
- the range of possible credit scores under the model used to generate the credit score;
- all of the key factors that adversely affected the credit score, which shall not exceed four factors, except that if one of the key factors is the number of inquiries made with respect to the consumer report, the number of key factors shall not exceed five;
- the date on which the credit score was created; and
- the name of the consumer reporting agency or other person who provided the credit score.

Also required is a statement that a credit score is a number that takes into account information in a consumer report and that a credit score can change over time to reflect changes in the consumer’s credit history. See attached Sample Adverse Action Notice and Credit Score Disclosure.

**Status:** The Dodd-Frank credit score disclosure requirement is scheduled to become effective on July 21, 2011. This has been established as the “designated transfer date” for the transfer of functions under vari-

ous consumer protection laws, including the FCRA, to the new Consumer Financial Protection Bureau (CFPB). As of this writing, there has been no indication this date will be delayed.

### Summary of Key Points

- If you or your resident screening company use a credit score as defined in FCRA Section 609(f)(2)(A), i.e., one used by lenders to arrange loans, in order to determine renter eligibility,  
  
AND,  
  
you take an adverse action, i.e., deny residency, charge a higher deposit, etc., then you must provide the new credit score disclosure along with the adverse action notice already required under FCRA. (See Sample Adverse Action Notice and Credit Score Disclosure below.)
  
- If you or your resident screening company use a score that is not a credit score as defined in FCRA Section 609(f)(2)(A) i.e., one that is not used by persons who make loans,  
  
AND  
  
You take an adverse action, i.e., deny residency, charge a higher deposit, etc., then you do not have to provide a credit score disclosure, BUT you must still provide an adverse action notice.

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*The information discussed in this document is general in nature and is not intended to be legal advice. It is intended to assist owners and managers in understanding this issue area, but it may not apply to the specific fact circumstances or business situations of all owners and managers. For specific legal advice, consult your attorney.*

## Glossary

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1. **Adverse Action:** A denial or revocation of credit, a change in the terms of an existing credit arrangement or a refusal to grant credit in substantially the amount or on substantially the terms requested. Such term does not include a refusal to extend additional credit under an existing credit arrangement where the applicant is delinquent or otherwise in default or where such additional credit would exceed a previously established credit limit. *(701(d)(6) of the Equal Credit Opportunity Act.)*
2. **Consumer Report:** A consumer report is a detailed report that provides personally identifiable information relating to one's credit, character or lifestyle. The FCRA only covers reports prepared by a consumer reporting agency; that is, a company that specializes in compiling the information into a report. Examples of consumer reports used by apartment owners are:
  - a credit report from a credit bureau, such as TransUnion, Experian and Equifax or an affiliate company;
  - a report from a tenant-screening service that describes the applicant's rental history based on reports from previous landlords or housing court records;
  - a report from a tenant-screening service that describes the applicant's rental history, and also includes a credit report the service got from a credit bureau;
  - a report from a tenant-screening service that is limited to a credit report the service got from a credit bureau; and
  - a report from a reference-checking service that contacts previous landlords or other parties listed on the rental application on behalf of the rental property owner.
3. **Credit:** The right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment *(702(d) of the Equal Credit Opportunity Act.)*
4. **Creditor:** Any person who regularly extends, renews or continues credit; any person who regularly arranges for the extension, renewal or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew or continue credit. *(702(e) of the Equal Credit Opportunity Act.)*
5. **Credit Score:**

Credit score has the same definition as found in FCRA Section 609(f)(2)(A)

  - a) The term "credit score"
    - i) means a numerical value or a categorization derived from a statistical tool or modeling system used by a person who makes or arranges a loan to predict the likelihood of certain credit behaviors, including default (and the numerical value or the categorization derived from such analysis may also be referred to as a "risk predictor" or "risk score"); and
    - ii) does not include
      - (1) any mortgage score or rating of an automated underwriting system that considers one or more factors in addition to credit information, including the loan to value ratio, the amount of downpayment or the financial assets of a consumer; or
      - (2) any other elements of the underwriting process or underwriting decision.
  - b) The term "key factors" means all relevant elements or reasons adversely affecting the credit score for the particular individual, listed in order of their importance based on their effect on the credit score.
6. **Materially less favorable:** The terms granted or extended to a consumer differ from the terms granted or extended to another consumer from or through the same person such that the cost of credit

to the first consumer would be significantly greater than the cost of credit to the other consumer. (75 FR 2724.)

7. **Material terms:** The annual percentage rate for credit that has an annual percentage rate or, in the case of credit that does not have an annual percentage rate, the financial term that the person varies based on the consumer report and that has the most significant impact on consumers, such as an annual membership fee or a deposit. For credit cards, which may have multiple annual percentage rates applicable to different features, “material terms” is defined generally as the annual percentage rate applicable to purchases. (75 FR 2724.)

## Sample Adverse Action Notice and Credit Score Disclosure

Date: \_\_\_\_\_

Applicant's Name: \_\_\_\_\_

Applicant's Address: \_\_\_\_\_

Description of Account, Transaction, or Requested Credit: \_\_\_\_\_

\_\_\_\_\_

Description of Action Taken: \_\_\_\_\_

\_\_\_\_\_

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### *Disclosure of Use of Information Obtained From an Outside Source*

Our credit decision was based in whole or in part on information obtained in a report from the consumer reporting agency listed below. You have a right under the Fair Credit Reporting Act to know the information contained in your credit file at the consumer reporting agency. The reporting agency played no part in our decision and is unable to supply specific reasons why we have denied credit to you. You also have a right to a free copy of your report from the reporting agency, if you request it no later than 60 days after you receive this notice. In addition, if you find that any information contained in the report you receive is inaccurate or incomplete, you have the right to dispute the matter with the reporting agency.

Name: \_\_\_\_\_

Address: \_\_\_\_\_

[Toll-free] Telephone number: \_\_\_\_\_

### *Credit Score Disclosure*

We also obtained your credit score from this consumer reporting agency and used it in making our credit decision. Your credit score is a number that reflects the information in your credit report. Your credit score can change, depending on how the information in your credit report changes.

Your credit score: \_\_\_\_\_

Date: \_\_\_\_\_

Scores range from a low of \_\_\_\_\_

to a high of \_\_\_\_\_

Key factors that adversely affected your credit score: \_\_\_\_\_

\_\_\_\_\_